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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 505

TRANSPORT TRADING & TERMINAL CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 3-14) are reported at 9 T. C. 247. The opinion of the Court of Appeals (R. 37-41) is reported at 176 F. 2d 570.

JURISDICTION

The judgment of the Court of Appeals was entered on July 11, 1949. (R. 42.) A petition for rehearing was filed on July 26, 1949 (R. 43-57), and

was denied on October 4, 1949 (R. 71). The petition for a writ of certiorari was filed on December 28, 1949. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

The taxpayer, for the sole purpose of avoiding tax on an imminent profit, declared a dividend in kind to its parent company, consisting of certain shares of stock in another company. This was done with the knowledge that the stock would be immediately sold or its value otherwise realized on.

Did the Court of Appeals err in deciding that the gain, realized by a sale of the stock, was taxable to the taxpayer?

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) [As amended by Section 1, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such prop-

erty; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C. 1940 ed., Sec. 22.)

SEC. 45. ALLOCATION OF INCOME AND DEDUCTIONS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

(26 U. S. C. 1940 ed., Sec. 45.)

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis pro-

vided in such section for determining loss over the amount realized.

* * * * *

(26 U. S. C. 1940 ed., Sec. 111.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

(26 U. S. C. 1940 ed., Sec. 112.)

STATEMENT

The findings of fact made by the Tax Court (R. 4-11) may be summarized as follows: The taxpayer corporation, which is engaged in shipping, terminal, dock, and warehouses operations, is a wholly owned subsidiary of a parent company, the American-Hawaiian Steamship Company. (R. 4.)

In 1929, the parent company purchased 10,000 shares of common stock of the Pacific-Atlantic Steamship Company, at a cost of $500,000. This constituted 20 percent of the outstanding stock of that company. In 1937, the parent company sold these shares to the taxpayer for $20,000. In its tax return for that year, the parent company claimed a loss of $480,000 on this sale, and the loss was used to offset substantial capital gains for that year. (R. 5.)

Pacific-Atlantic, which was engaged in intercoastal shipping, owned 13 ships at the beginning of 1940. Its operations had not been profitable; the taxpayer and the other large stockholders were desirous of getting out of the company. At that time there was a good market for ships and the larger stockholders decided that it was for the best interests of all the stockholders that the ships and assets of the company be sold. Authority to make such sales was secured from the stockholders and by June 1, 1940, nine of the ships had been sold. There was then pending an offer from the British Ministry of Shipping to purchase the remaining four ships at $50 per deadweight ton. (R. 5-6.)

On June 10, 1940, Charles E. Dant, one of the large stockholders, called an informal meeting of the stockholders to discuss the pending offer from the British Ministry of Shipping. Dant was averse to accepting the offer because he did not want the Pacific-Atlantic Company to go out of business. He stated to those present, including the taxpayer, that if they would not insist on the sale of the ships, he would "guarantee them 'against any loss if the ships were not sold either by buying them or working out some other arrangement.'" Dant did not say how he would carry out his assurance, but at this meeting the parties also reached a basis for the valuation of the common stock of Pacific-Atlantic—the four unsold ships were to be valued at $50 per ton deadweight, treated as though sold at that price,

and the profit taken into account subject to federal and state taxes; the profits on all voyages in progress on June 10, 1940, were also to be taken into account. As a result of this meeting, the authority to sell the remaining four ships was rescinded. (R. 6-7.)

On July 15, 1940, the taxpayer increased its capital stock by $900,000, par value, the shares being issued to the parent company in exchange for $537,000 in cash and for shares of stock in another steamship company. (R. 8.)

On October 1, 1940, Dant and the president of Pacific-Atlantic instructed a firm of public accountants to compute the book value of the Pacific-Atlantic common stock in accordance with the basis mentioned above. September 30, 1940, was chosen as the valuation date because all voyages pending on June 10 were completed by that time. This audit showed a book value of $63.11 per share. (R. 8-9.)

On October 21, 1940, the taxpayer's directors declared a dividend on its capital stock consisting of the 10,000 shares of Pacific-Atlantic stock. The stock was transferred to the parent company on October 25, 1940. (R. 9.)

On October 31, 1940, a meeting was held at which Dant inquired whether the group present would agree to the sale of the remaining ships to Dant or to one of his companies at $35 per ton. The taxpayer's parent objected to a sale at less than market value. A later meeting was held on November 11, 1940, at which various proposals were rejected. It

was finally agreed that Dant or one of his companies would purchase the stock from the Pacific-Atlantic stockholders at $60 per share, with an adjustment for possible additional tax liabilities of Pacific-Atlantic. On November 25, 1940, the taxpayer's parent delivered the 10,000 shares of Pacific-Atlantic stock to one of Dant's companies for a final adjusted price of $582,285. (R. 10.)

The Commissioner, in his deficiency determination, included in the taxpayer's taxable income for 1940 the sum of $562,285, that being the difference between the cost basis to the taxpayer and the selling price of the stock. (R. 11.) The Tax Court refused to sustain the Commissioner's deficiency determination. (R. 11-14.) The Court of Appeals reversed the Tax Court, holding that the Commissioner should have been sustained. (R. 37-41.)

ARGUMENT

1. The principal attack made by the taxpayer on the decision of the Court of Appeals rests on the assertion that it exceeded its reviewing authority with respect to certain factual issues. (Pet. 3-5, 11-12, 14-20.) An examination of the specific matters complained of, however, fails to reveal that these errors are embodied in the opinion written by Judge Learned Hand or that the decision results from any such usurpation of power by the court below.

a. The taxpayer first asserts that the Court of Appeals (Pet. 3-4)—"* * * without any support

in the record and directly contrary to findings of the Tax Court fully supported by the record * * *"—determined that the ultimate purchaser (Dant) had agreed to purchase the "Pacific-Atlantic shares" at the taxpayer's election. This assertion, which is basic to the taxpayer's complaint (Pet. 3-4, 10-12, 13, 14, 18), misconceives the decision of the Court of Appeals and the factual findings of the Tax Court. Judge Hand's opinion does not rest on the rationale that the purchaser was obligated to buy the shares of stock; it holds only that the purchaser was at least " 'committed' to buy the ships" from the Pacific-Atlantic Company. (R. 40.) The Tax Court made no findings contrary to this. Actually, the Tax Court's findings with respect to the offer require such a conclusion, as the very minimum, for Dant was found by the Tax Court to have "guarantee[d] them [the Pacific-Atlantic shareholders] 'against any loss if the ships were not sold *either by buying them* or working out some other arrangement.' " (R. 7, italics added.) Since Dant was obligated to purchase the ships, and since these were the only remaining assets of the Pacific-Atlantic Company (R. 6), it was an inevitable conclusion that, by requiring the purchaser to carry out his minimum commitment, the Pacific-Atlantic stockholders would eventually realize on the value of their shares. The court below did not conclude that the stockholders had a right to compel the purchaser to buy their shares in a direct purchase. The

opinion, after referring to Dant's undeniable offer to buy the ships, carefully states that (R. 40) "* * * *that in effect* gave them—the taxpayer included—an option to sell the shares to him, if they elected to do so." (Italics added.)[1]

The Tax Court, moreover, completely overlooking what the purchaser was bound to do, placed its emphasis on the fact that the stockholders were not bound to sell their shares. (R. 13-14.) The Court of Appeals did not deny this. It concluded, however, that the significant fact was that the taxpayer and the parent company had determined to require the purchaser to carry out his obligation, a matter not denied by the Tax Court and which, as the court below pointed out (R. 40), could not be denied on the record.

b. The second matter in which the Court of Appeals is supposed to have exceeded its reviewing authority (Pet. 4) is its conclusion (R. 41) that the taxpayer's distribution of the shares to the parent was done only to escape tax. The complaint here is not that this conclusion conflicts with a finding made by the Tax Court, but only that (Pet. 4): "* * * the Tax Court had made no finding one way or the other * * *." The Tax Court actually noted (R. 14) that it was a "conceded fact" that

[1] It is significant (a) that on June 10, 1940, when Dant made his commitment, the parties present at the meeting simultaneously agreed upon a basis for the valuation of the Pacific-Atlantic stock which valued the ships at $50 per ton (R. 7), and (b) that as soon as the stock could be valued on the agreed basis, the valuation was undertaken early in October (R. 8-9). *Supra*, pp. 5-6.

the taxpayer knew, at the time that it transferred the stock to the parent, that it would have a large taxable gain if the shares were sold directly or if the Pacific-Atlantic Company were liquidated. The record, moreover, does not disclose, and the taxpayer is unable to suggest any *bona fide* reason why this inter-company transaction did take place. The taxpayer's attempted explanation below, which has not been repeated here, was properly rejected by the court as being invalid. (R. 41.) Except for the attempt to avoid the tax, the transfer to the parent was without reason.

c. The final factual matter in which the taxpayer claims that the Court of Appeals went beyond the proper scope of review is the court's conclusions that the subsidiary had no will different or independent from that of the parent and that the ultimate financial interests of both companies were the same. (Pet. 4.) Again, it will be noted that the Tax Court made no contrary findings, and, we submit, none would be possible. The fact that the taxpayer's stock was wholly owned by the parent and that they possessed common officers and directors (R. 4) inevitably leads to the conclusion that the subsidiary's actions were controlled by the parent and that they possessed no conflicting financial interests. The court could reach no other conclusion but that (R. 41) "* * * the proceeds of the sale were in any event to reach the same treasury * * *."

The taxpayer's attempt (Pet. 3, 4) to present the case as though the Court of Appeals had tried these matters *"de novo"* is, accordingly, without foundation.

2. There is a similar lack of merit to the taxpayer's alternative contention that the Court of Appeals should have, at least, remanded the case to the Tax Court. (Pet. 18-20.) The basis for this argument is the unwarranted premise that the court below reached its decision by disregarding corporate entities (Pet. 18), and that the Commissioner had disclaimed any such contention in the Tax Court (Pet. 19). The Court of Appeals, in concluding that the subsidiary's will was dominated by the parent and that the two corporations had an identity of financial interests, did not disregard corporate entities. It was merely stating a self-evident conclusion. Indeed, there would have been no need for Judge Hand to have reasoned as he did in the opinion if the court had simply disregarded the corporate entity of the parent. Furthermore, if the court below had disregarded any corporate entity, its reasoning would have required that the subsidiary's should be ignored. This, of course, is contrary to its decision that the gain was taxable to the subsidiary.

3. On the undeniable facts of the case, the Commissioner was warranted in concluding that, as between these two members of an inter-corporate

family, the gain was realized by the subsidiary. It will be noted that this very block of stock in the Pacific-Atlantic Company had been the subject of an inter-company transfer which occurred only three years previously—a transaction whereby the parent sold the stock to the taxpayer for $20,000, and as a result of which it claimed and was allowed a capital loss deduction of $480,000 in its tax return for 1937. (R. 5.) It was this same stock which was again sold in the taxable year for $582,285. (R. 10.) It is also significant that only three months prior to the so-called "dividend distribution" of the Pacific-Atlantic Company stock to the parent, and after the time that the purchaser had made his commitment, the taxpayer increased its capital stock by $900,000, the shares being issued to the parent in exchange for $537,000 in cash and shares of stock in another steamship company. (R. 8.)

The transfer of the Pacific-Atlantic stock to the parent in this case, moreover, was made by the taxpayer while it was actively engaged in business, so that a direct sale of that stock by the taxpayer would have resulted in its having realized normal business profits. This case is thus different from *United States* v. *Cumberland Public Service Co.*, decided by this Court on January 9, 1950 (No. 214, October Term, 1949), where the corporation was being dissolved and where it distributed its assets to the stockholders in a liquidating dividend. Indeed, the opinion in the *Cumberland* case empha-

sizes the liquidation and dissolution of the corporate taxpayer, and expressly points out that (slip opinion, p. 4) "The corporate tax is thus aimed primarily at the profits of a going concern."[2] The Commissioner, as he is authorized to do under Section 45 of the Internal Revenue Code, *supra*, p. 3, could properly conclude that, with respect to these corporations, both owned by the same interests, the gain should be attributed to the taxpayer "* * * in order to prevent evasion of taxes or clearly to reflect the income * * *" of the subsidiary. The court below, relying on *Gregory* v. *Helvering,* 293 U. S. 465, upheld the Commissioner in deciding that the taxpayer could not avoid being taxed on its going concern business profits by the device of a dividend in kind to the parent, where this had no purpose except to avoid such taxation. While the taxpayer seeks to limit the *Gregory* case to its precise facts (Pet. 5, 13, 20-22), the contrary has been frequently held. *Minnesota Tea Co.* v. *Helvering,* 302 U. S. 609; *Griffiths* v. *Commissioner,* 308 U. S. 355; *Higgins* v. *Smith,* 308 U. S. 473.

In short, the court below has merely held that, in the circumstances of this case, the Tax Court plainly erred in holding that the dividend distribution must be viewed as genuine, and the sale of the stock as, in substance, one made not by the taxpayer

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[2] *Commissioner* v. *Court Holding Company,* 324 U.S. 331, also involved a liquidation and dissolution. In both cases, furthermore, the taxpayer's stockholders were individuals and not corporations.

but by its parent. There is no indication that the court took a view of *Commissioner* v. *Court Holding Company,* 324 U. S. 331, different from that recently expressed in the *Cumberland Public Service Co.* case,[3] and the issue, therefore, turns solely on an evaluation of the particular facts of this case. We suggest that the lower court, in reversing the Tax Court, no more went beyond the broader reviewing functions conferred on it by Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948, c. 646, 62 Stat. 869, than it did in *National Carbide Corp.* v. *Commissioner,* 336 U. S. 422, where, despite the narrower reviewing powers which then prevailed under *Dobson* v. *Commissioner,* 320 U. S. 489, the Second Circuit was sustained in reversing the Tax Court for having held that the income there in question was taxable to the parent rather than to the subsidiary.

4. Nor is there a conflict with *General Utilities Co.* v. *Helvering,* 296 U. S. 200 (Pet. 22-25). Although the taxpayer cites that case as having held that a corporation does not realize gain if it makes a dividend distribution in kind to its stockholders, there has been considerable confusion as to the precise holding of the case on that point, a confusion engendered by the cryptic remarks on that issue in

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[3] In *Fairfield S. S. Corp.* v. *Commissioner,* 157 F. 2d 321, 322 (see 5 T.C. 566, 576), certiorari denied, 329 U.S. 774, on which the opinion below relies (R. 40), the Second Circuit, also per L. Hand J., took a narrow view of the holding in favor of the Commissioner in *Court Holding.*

the opinion written by Justice McReynolds. But even if it be assumed that the taxpayer is correct in asserting that such was the decision of that case, it has no application here. The court below did not decide that the taxpayer realized taxable gain because it made a dividend distribution in kind to the parent. The taxpayer, instead, was held to have realized taxable gain because of the ultimate sale of the stock, and because the dividend distribution was merely a tax avoidance device which should be disregarded. It was not held taxable because it distributed the dividend; actually, it was held taxable despite the dividend distribution. The *General Utilities* case, which was not even mentioned by the court below, is not in conflict with its decision.

CONCLUSION

The decision below is correct. There is no conflict in decisions. Further review of this case would not be warranted. The petition for a writ of certiorari, accordingly, should be denied.

Respectfully submitted,

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